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Supreme Court of the United States.

OCTOBER TERM, 1936.

No. 703

OLD COLONY TRUST COMPANY, TRUSTEE,
PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:—

The Old Colony Trust Company, a corporation organized under the laws of Massachusetts, respectfully represents as follows:—

1. The petitioner is the surviving trustee under a deed dated July 22, 1922, whereby Paul Wilde Jackson, a resident of Braintree, Massachusetts, conveyed to the petitioner and George E. Brock (who died June 10, 1923) property of large value in trust to make certain outright payments not now material and to pay annuities in specified amounts to various individuals. The deed then continued as follows:—

> "13. I authorize my said trustees to pay to charities as hereinafter described such sums as in their judgment may be paid without jeopardizing the annuities

herein provided for, whenever for a period of one year the trust fund held by them as then invested shall have yielded a net income equal to twice the amount of the annuities which they are then required to pay, and upon the death of the survivor of those persons, who under the terms of this instrument are to receive annual incomes under the trust hereby created, I direct my said trustees to distribute the rest and residue remaining in their hands among corporations and trustees organized, operating and holding exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, the sum paid over by said trustees to such corporations or boards of trustees to be held by such corporations and boards of trustees in trust, and the income thereof to be expended for the general purposes for which such corporations and boards of trustees are organized, and I request that said funds be designated by each corporation or board of trustees as the Henry Clay Jackson Fund."

2. The income of the trust for each year since the petitioner has held the principal has been more than twice the annuity payments required in such year by the terms of the trust.

3. The principal (corpus) account of the trust has always been maintained separate and apart from the income account.

4. The accumulated income on hand on January 1, 1931, was $187,999.43. On the same date the market value of the trust corpus was $2,119,835.81. The capital value of the annuities in 1931 was approximately $200,000.

5. The gross income of the trust for the year 1931 (including gains from the sale of securities aggregating

$60,901.82) was $175,319.18. The annuity payments during that year aggregated $22,350. The expenses of the trust for the same year aggregated $11,029.79. There remained therefore a balance of $141,939.39 which it was competent for the trustee to apply to charity in accordance with the terms of the deed.

6. During the year 1931 the petitioner in the exercise of the power conferred upon it by the deed paid to various charities a total of $190,000, all these charities being of the kind referred to in §162 (a) of the Revenue Act of 1928.* Each of these payments was charged by the petitioner against the income of the trust.

7. The petitioner filed a fiduciary return for 1931 showing income apportioned to the annuitants and to itself. It also filed an individual return for the same year in which, in reliance on §162 (a) of the Revenue Act of 1928, it claimed as deductions on account of sums applied to charity amounts equal in the aggregate to the total net income, including capital gains. The Commissioner of Internal Revenue disallowed any deduction on the sole ground that it was "not disclosed that payments were made out of income of the taxable year to the charities nor that any portion of

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* The material part of §162 of the Revenue Act of 1928 is as follows:—

"*Sec. 162. Net income.* The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

"*Sec. 162.* (*a*) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 [n]) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit.

the income was credited to charity." The petitioner thereupon applied to the Board of Tax Appeals for a redetermination.

8. At the hearing before the Board of Tax Appeals it was not contended by the Commissioner that the payments in question were not made "pursuant to the terms of the . . . deed creating the trust" within the meaning of §162 (a) of the Revenue Act of 1928 and the hearing proceeded on the footing that they were so made. The question considered was whether it was necessary for the trustee, in order to enjoy the benefit of the deduction, to show that the payments were made out of income received during 1931.

9. The Board of Tax Appeals unanimously held that the payments in question were not made out of principal. The majority held (1) that, in view of the possibility that accumulated income might in some future year be used for annuity payments, the income received by the trust during 1931 and not required for expenses or for the annuity payments of that year did not constitute income "to be used exclusively" for charitable purposes within the meaning of the statute and (2) that, as regards sums actually paid to charitable institutions during 1931, it was incumbent upon the trustee to prove affirmatively that these sums were paid out of income received in the same year; it was held that as to contributions aggregating $2,000.57 it appeared that these were made from the gross income of 1931 and might, therefore, be claimed as deductions, but that as to the balance of the contributions in question (aggregating $187,999.43) the trustee had not shown that the payments were so made and that in consequence they were not deductible. The minority, without undertaking to determine whether the income in question was "to be used exclusively" for charitable purposes, held in substance that the

deduction should be allowed on the ground that contributions which are as between trustee and beneficiary properly chargeable against the amounts constituting for tax purposes the gross income of the trust are to be allowed as deductions and that it is immaterial whether the trustee takes the money so applied out of income actually received during the current year or takes it out of income on hand at the beginning of the year and suffers the income thereafter received to accumulate.

10. Both parties petitioned the Circuit Court of Appeals for the First Circuit to review the decision of the Board of Tax Appeals. The trustee assigned as error the Board's holdings "that gifts made to charities in 1931 were not deductible unless shown to have been made from gross income received by the trust in that year" and "that the difference between the petitioner's net income for 1931 as determined by the respondent and the amounts paid to annuitants was . . . [not] to be used exclusively for charitable purposes within the meaning of Section 162(a) of the Revenue Act of 1928." The Commissioner assigned as error the Board's failure to hold "that the amount of $2,000.57 was paid out of the corpus of the estate created under the trust indenture." The docket numbers of the two cases in the Circuit Court of Appeals are 3145 and 3146 respectively.

11. At the hearing in the Circuit Court of Appeals the Commissioner put forward as his principal reliance a contention that, even if all the payments in question were unquestionably made out of income received during the same year, none of them were deductible, because the deed did not imperatively require them to be made, but gave the trustees power to make them as a matter of discretion; it was said that for this reason the payments could not be deemed to have been made "pursuant to the terms of the deed creating the trust" within the meaning of §162 (a) of the Revenue Act

of 1928. The respondent argued that the Board of Tax Appeals rightly proceeded on the assumption that the words "pursuant to" were to be taken in their normal sense of "agreeably to" or "in accordance with" and that on this assumption the minority of the Board were right in maintaining that the petitioner, in order to be entitled to the deduction, was not bound to prove affirmatively that the sums contributed to charity during 1931 were paid from the particular income received during that year and not from the accumulated income of former years. It was further argued by the petitioner that, if the income should not be deemed to have been paid for charitable purposes during 1931, it must be regarded as income "to be used" for such purposes within the meaning of §162 (a) of the Revenue Act of 1928, inasmuch as the entire trust estate was by the express terms of the will devoted in the first instance to charity and as there was only a theoretical possibility that there would ever be occasion to divert accumulated income to non-charitable purposes.

12. The majority of the Circuit Court of Appeals, without passing upon the issue which had given rise to the division of opinion in the Board of Tax Appeals, sustained the contention made by the Commissioner as to the meaning of the words "pursuant to" and further held that none of the income in question was "to be used" for charitable purposes within the meaning of the statute; it was accordingly ordered that the case be remanded to the Board of Tax Appeals with instructions to reinstate the Commissioner's determination *in toto*. Judge Morton filed a dissenting opinion.

13. The decision of the Circuit Court of Appeals presents in the following particulars points calling for review by this court:—

I. Concerning the right to claim deductions on account of payments actually made to charitable institutions during the taxable year,—

(*a*) As to whether these payments were made "pursuant to" the terms of the trust instrument,—

(i) The language of §162 (a) of the Revenue Act of 1928 is repeated without change in the respective sections of the same number in the Revenue Acts of 1932, 1934 and 1936. Provisions whereby trustees are authorized, but not absolutely required, to apply the income of the trust estate to charity are found in many trust instruments. If the present decision stands, it will mean that not only under the Revenue Act of 1928, but under the several later acts, all the income of such estates is taxable, even though applied in its entirety to charity. The public interest in the authoritative determination of this question is manifest.

(ii) If it was competent for the Commissioner to insist for the first time at the argument before the Circuit Court of Appeals that the payments in question were not made "pursuant to" the terms of the trust instrument, the construction put upon these words by the majority of the court is plainly wrong. As pointed out in the dissenting opinion, this construction is not only inconsistent with the policy of Congress in encouraging contributions to charity, but is repugnant both to common usage and to substantially all the authorities, both federal and otherwise.

(*b*) As to whether the petitioner had the burden of showing that the payments were made out of funds received during the taxable year and not out of accumulated income,—

(i) The ruling of the majority of the Board of Tax Appeals to the effect that the petitioner must show from what receipts the payments to charities were made in order to claim a deduction is inconsistent with the plain intent of Congress.

(ii) The effect of this ruling, if it were finally accepted, would be largely to render nugatory the provision for the deduction of contributions by trust estates to charity, since the practical exigencies of administration often make it necessary to carry over income from one year to another and impossible to determine whether a particular payment is made from funds received during the current year.

II. Concerning the right to claim a deduction on the ground that the excess of the income of the trust for the taxable year over the expenses and annuity payments for that year, whether paid out or not, was "to be used exclusively" for charitable purposes,—

The trust deed required that the entire estate, both principal and income, be applied, except so far as necessary for the purposes of the annuities, to charity. The excess in the income of 1931 over the limited amount required for the annuity payments of that year thus became charged with a charitable trust, subject to the condition subsequent that in some future year the trustee might draw upon it to provide the annuity payments then accruing. In *Hartford-Connecticut Trust Co.* v. *Eaton*, 36 Fed. (2d) 710, the Circuit Court of Appeals for the Second Circuit (affirming 29 Fed. [2d] 840) held that in such a situation the excess of the receipts over the aggregate of the annuity payments for the current year constitutes income "to be used exclusively for religious, charitable, scientific or educational purposes" within the meaning of §162 (a) of the Revenue Act of 1928, notwithstanding the possibility that through the operation of the condition subsequent such excess may be diverted to a non-charitable use. In the case at bar it was held on the contrary that, so long as such a condition subsequent is outstanding, even though the possibility that it may ever take effect is very remote, the sums in question cannot be regarded

as income "to be used exclusively" for charitable purposes; in this particular the decision was in line with the opinion rendered by the same court in *Boston Safe Deposit & Trust Co.* v. *Commissioner of Internal Revenue*, 66 Fed. (2d) 179, in which the view taken in *Hartford-Connecticut Trust Co.* v. *Eaton, supra*, was expressly disapproved. The case thus presents a conflict between the decisions in two circuits upon an important question of statutory construction.

The petitioner therefore prays that a writ of certiorari issue out of this court to the United States Circuit Court of Appeals for the First Circuit commanding that the said cases numbered respectively 3145 and 3146 be certified to this court for review and determination.

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